

INTERNAL REVENUE SERVICE
DIRECTOR, EXEMPT ORGANIZATIONS

DEPARTMENT OF TREASURY
PACIFIC COAST AREA (TE/GE)

2 Cupania Circle
Monterey Park, CA 91755
ATTN: TE/GE:REV:WLS

Date: JUN 23 2000

Telephone Number: [REDACTED]

CERTIFIED MAIL

Dear Applicant:

We have considered your application for recognition of exemption under section 501(c)(3) of the Internal Revenue Code.

THE FACTS

The information submitted indicates that you were incorporated on [REDACTED]. Your Articles of Incorporation, in part, state that your specific purposes are, "To study, evaluate, provide for, promote, advance, improve, support and facilitate the genetic improvement of [REDACTED]; to provide for and promote the performance testing of [REDACTED] and perform all necessary functions necessary to carry out such testing; to establish operate and main testing stations and other facilities; to enter into agreements, contracts and research and testing programs with individuals, corporations, associations, educational institutions, within and without [REDACTED], to carry out the purposes of the Corporation; to conduct, develop, promote and participate in scientific and educational programs to upgrade and improve [REDACTED] production; to apply for and hold patents in its own name, enter into agreements with inventors, licensees and market the patents and defend in courts of competent jurisdiction patent rights of the corporation; to utilize funds received for the purpose of research extension and academic programs and related activities and to enter into legal arrangements with any partnership, corporation, or person, to perform the contracts which are necessary to accomplish the services and activities pertinent thereto; to be responsible for the employment, supervision and direction of all personnel appropriate for the operation of the Corporation; and to enter into contractual agreements with any other persons, partnership or corporation for the use of the buildings, laboratories, equipment and personnel as well as any other items and services deemed essential to properly effectuate the purposes of the Corporation."

Your application 1023 states that your activities are: to locate and recognize [REDACTED] by demonstrating and evaluating post weaning growth and development on silage based rations; provide [REDACTED] of all sizes with an economically sound alternative to growing and developing [REDACTED] at home and at the same time assist in the identification and improvement of economically important traits; and to establish a continual supply of [REDACTED] for both commercial and purebred [REDACTED] that will [REDACTED] for the future.

Your sole sources of income are gross receipts from program service revenues which are nomination fees (the fees charged for [REDACTED] and feeding revenues.

Your current fee schedule is:

\$ [REDACTED]
\$ [REDACTED], and
\$ [REDACTED] e. [REDACTED]

Recipients/purchasers of this testing must be [REDACTED]

In addition, you hold two sales per year, with the top 70% of [REDACTED] in each category in the testing program being eligible for sale, although not mandatory to be put up for sale. [REDACTED] receive the sale proceeds less any amount due the Center for costs.

THE LAW

Section 501(c)(3) of the Code describes certain organizations exempt from income tax under section 501(a) and reads, in part, as follows:

"(3) Corporations, and any community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals, no part of the net earning inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, and which does not participate in, or intervene in, any political campaign on behalf of any candidate for public office."

Section 1.501(a)-1 of the Income Tax Regulations provides that the words, "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 501(c)(3)-1(d)(ii) of the regulations provides that an organization is not organized and operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creators, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense.

Section 512 of the Code provides that the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less allowable deductions directly connected with conducting such trade or business.

Section 513 of the Code defines the term, "trade or business" as any trade or business the conduct of which is not substantially related (aside of the need of such organization for income or funds or the use of the profits derived) to the exercise or performance by such organization of its exempt functions. The term has the same meaning it has in IRC 162, and generally includes any activity carried on for the production of income from the sale of goods or provision of services. Activities of producing or distributing goods or performing services from which a particular amount of gross income is derived do not lose identity as a

trade or business merely because they are carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. See Regulations 1.513-1(b).

Section 1.513-1(c)(1) of the Income Tax Regulations provides in substance that to determine whether trade or business is "regularly carried on" one must look at the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued. It further provides that specific business activities are regularly carried on if they are in these respects generally similar to comparable commercial activities of nonexempt organizations.

Section 1.501(c)(3)-1(d)(5)(ii) states, "Scientific research does not include activities of a type regularly carried on as an incident to commercial or industrial operations, as, for example, the ordinary testing or inspection of materials or products or the designing or construction of equipment, buildings, etc."

See Revenue Ruling 69-51, 1969-1 C.B. 159, wherein an agricultural organization exempt from income tax under section 501(c)(5) of the Code carries on unrelated business within the meaning of section 513 of the Code where it conducts a marketing activity. The organization's purpose is to promote the betterment of conditions of breeders of Angus cattle and to improve the breed generally. The organization regularly sells cattle for its members on a commission basis. The marketing of livestock by this organization constitutes an unrelated trade or business under section 513 of the Code.

See Revenue Ruling 70-372, 1970-2 C.B. 118, wherein an organization was held not exempt as an agricultural organization. The organization was composed of agricultural producers and formed to process production data for farmers for use in improving milk production of their own dairy herds.

See Revenue Ruling 74-518, 1974-2 C.B. 166, wherein an organization was held exempt as an agricultural organization. The organization operated as an integral and necessary part of a nationwide program to improve milk production by supplying milk production statistical analysis to the US Department of Agriculture as well as milk production records to the individual producers.

In *Better Business Bureau of Washington, D.C., Inc. v. United States*, 326 U.S. 279 (1945), the Supreme Court of the United States interpreted the requirement in section 501(c)(3) that an organization be "operated exclusively" by indicating that, in order to fall within the claimed exemption, an organization must be devoted to exempt purposes exclusively. This plainly means that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number and importance of truly exempt purposes.

DISCUSSION

Your case indicates that you are an organization whose activities are of a commercial nature regularly carried on for the production of income as defined in section 1.513-1(c)(1) of the Income Tax Regulations...

In addition, you provide a private benefit to [REDACTED], for-profit entities, by testing and [REDACTED] and providing the test results to them, thereby promoting their businesses.

By serving primarily the interest of private individuals, you are not operated exclusively for an exempt purpose. See section 1.501(c)(3)-1(c)(1) and 1.501(c)(3)-1(d)(1)(ii) of the regulations. See also *Better Business Bureau*, supra.

You are analogous to a great extent to the organization described in Revenue Ruling 69-51 whose purpose was to promote the betterment of breeders of Angus cattle, but whose marketing of the livestock constituted an unrelated trade or business. Your income is derived solely from [REDACTED] and [REDACTED] paid by [REDACTED].

Your organization is similar to the organization described in Revenue Ruling 70-372, wherein the basis of the denial of exemption was that the processing of production and test records for individuals was a service that simply relieved the farmers of work that they either normally perform themselves or have performed for them and did not in itself better conditions of those engaged in agricultural pursuits improve the grade of their products or develop a higher degree of efficiency in their operation.

You are distinguishable from the organization described in Revenue Ruling 74-518, wherein the basis for granting exemption was that the organization benefited dairymen in general and that the individual benefits were incidental to the objectives of the program as a whole whereas the organization which was the subject of Revenue Ruling 69-51 and Revenue Ruling 70-372 merely benefited their own members.

Moreover, you are carrying on a trade or business as defined in section 513 of the Internal Revenue Code as your sole source of income is program service revenue.

CONCLUSION

Therefore you do not qualify for exemption under section 501(c)(3).

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file federal income tax returns by using Form 1120.

You have the right to protest this ruling if you believe that it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days of the date of this letter and must be signed by one of your officers. You also have a right to a conference in this office after your statement is submitted. If you want a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your officers, he/she must file a proper power of attorney and otherwise qualify under Conference and Practice Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgement or decree under this section shall not be issued in any proceeding, unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final. If you have any questions please contact the person at the telephone number shown above.

If this letter becomes our final determination, the appropriate state officials of the State of Texas will be notified of this action in accordance with section 6104(c) of the Code.

Sincerely yours,



Steven T. Miller

Director, Exempt Organizations

Enclosures:
Publication 892
Notice 1214